(ii) The claim must be made on Form 8849 (or such other form as the Commissioner may designate) in accordance with the instructions on the form. The form should be marked *Section 4081(e) Claim* at the top. Section 4081(e) claims must not be included with a claim for a refund under any other provision of the Internal Revenue Code.

(2) *Information to be included in the claim*. Each claim for a refund under section 4081(e) must contain the following information with respect to the taxable fuel covered by the claim:

(i) Volume and type of taxable fuel.

(ii) Date on which the claimant incurred the tax liability to which this claim relates (the second tax).

(iii) Amount of second tax that claimant paid to the government and a statement that claimant has not included the amount of this tax in the sales price of the taxable fuel to which this claim relates and has not collected that amount from the person that bought the taxable fuel from claimant.

(iv) Name, address, and employer identification number of the person that paid the first tax to the government.

(v) A copy of the first taxpayer's report that relates to the taxable fuel covered by the claim.

(vi) If the taxable fuel covered by the claim was bought other than from the first taxpayer, a copy of the statement of subsequent seller that the claimant received with respect to that taxable fuel.

* * * * *

(g) *Effective date.* This section is effective in the case of taxable fuel with respect to which the first tax is imposed after September 30, 1995.

Par. 11. Section 48.4101–3 is added to read as follows:

§ 48.4101–3 Registration.

(a) A refiner that is registered under section 4101 may treat itself with respect to the bulk removal of any batch of gasohol from its refinery as a person that is not registered under section 4101. See § 48.4081–3(b)(1)(iii).

(b) This section is effective October 1, 1995.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 12. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§ 602.101 [Amended]

Par. 13. In § 602.101, paragraph (c) is amended by removing the entry for 48.4041–21 from the table and adding the entry ''48.4041–21.....1545–1270'' in numerical order to the table.

Margaret Milner Richardson,

Commissioner of Internal Revenue.

Approved: July 25, 1995.

Leslie Samuels,

Assistant Secretary of the Treasury.

[FR Doc. 95–19284 Filed 8–4–95; 8:45 am]

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26 CFR Part 301

[TD 8610]

RIN 1545–AP98

Taxable Mortgage Pools

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to taxable mortgage pools. This action is necessary because of changes made to the law by the Tax Reform Act of 1986. The final regulations provide guidance to entities for determining whether they are subject to the taxable mortgage pool rules.

EFFECTIVE DATE: These regulations are effective September 6, 1995.

FOR FURTHER INFORMATION CONTACT: Arnold P. Golub or Marshall D. Feiring, (202) 622–3950 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

A notice of proposed rulemaking (FI–55–91) under section 7701(i) of the Internal Revenue Code was published in the **Federal Register** on December 23, 1992 (57 FR 61029). Written comments relating to this notice were received, but no public hearing was requested or held. After consideration of the comments, the proposed regulations under section 7701(i) are adopted as revised by this Treasury decision.

Explanation of Provisions

Section 301.7701(i)–1(c)(1)—Basis Used To Determine the Composition of an Entity's Assets

Among other requirements, to be classified as a taxable mortgage pool, substantially all of an entity's assets must consist of debt obligations, and more than 50 percent of those debt obligations must consist of real estate mortgages (or interests therein). Under the proposed regulations, an entity must apply these tests using the tax bases of its assets. One commentator, however, suggested that the entity should have the choice of using either the tax bases of its assets or the fair market value of its assets. The IRS and Treasury believe that using fair market value for the asset composition tests creates uncertainty and administrative difficulties. The final regulations, therefore, retain the rule in the proposed regulations.

Section 301.7701(i)–1(c)(5)—Seriously Impaired Real Estate Mortgages Not Treated as Debt Obligations

Under the proposed regulations, real estate mortgages that are seriously impaired are not treated as debt obligations for purposes of the asset composition tests. Whether real estate mortgages are seriously impaired generally depends on all the facts and circumstances. The proposed regulations, however, provide two safe harbors. Under those provisions, whether mortgages are seriously impaired depends only on the number of days the payments on the mortgages are delinquent (more than 89 days for single family residential real estate mortgages and more than 59 days for multi-family residential and commercial real estate mortgages). The safe harbors are not available, however, if an entity is receiving or anticipates receiving certain payments on the mortgages such as payments of principal and interest that are substantial and relatively certain as to amount.

Several commentators have asked for additional safe harbors based on factors other than the number of days a mortgage is delinquent. For example, one suggested a safe harbor for mortgages having excessively high loan to value ratios. Others suggested a safe harbor for mortgages that are purchased at a substantial discount.

The final regulations retain, unchanged, the safe harbors of the proposed regulations. The IRS and Treasury believe that no single factor is as clear an indication that a mortgage is seriously impaired as days delinquent. For example, a mortgage may be purchased at a discount for a variety of reasons, some of which bear no relation to the quality of the mortgage. To provide further guidance, however, the final regulations list some of the facts and circumstances that should be considered in determining whether a mortgage is seriously impaired.

Another commentator has criticized the safe harbors because they are unavailable if an entity anticipates receiving certain payments on a delinquent mortgage. The commentator is concerned that a test based on whether an entity anticipates receiving payments on a mortgage is both subjective and open-ended. To address this concern, the final regulations create a new rule, under which if an entity makes reasonable efforts to resolve a mortgage and fails to do so within a designated time, then the entity is treated as not having anticipated receiving payments on the mortgage.

Section 301.7701(i)–1(d)(3)(ii)—Obligations Secured by Other Obligations Treated as Principally Secured by Real Property

Under the proposed regulations, an obligation is treated as a real estate mortgage if it is principally secured by an interest in real property. Whether an obligation is principally secured by an interest in real property ordinarily depends on the value of the real property relative to the amount of the obligation. The proposed regulations also provide that an obligation secured by real estate mortgages is treated as an obligation secured by an interest in real property. That obligation, therefore, may itself qualify as a real estate mortgage.

The final regulations retain these rules and clarify how they are applied if an obligation is secured by both real estate mortgages and other property. Under the final regulations, such an obligation is treated as secured by real property, but only to the extent of the combined value of the real estate mortgages and any real property that secures the obligation.

Section 301.7701(i)–1(f)(3)—Certain Liquidating Entities Not Treated as Taxable Mortgage Pools

The proposed regulations provide that an entity formed to liquidate real estate mortgages is not treated as a taxable mortgage pool if the entity meets four conditions. One condition is that the entity must liquidate within three years of acquiring its first asset. If the entity fails to liquidate within that time, then the payments the entity receives on its assets must be paid through to the holders of the entity's liabilities in proportion to the adjusted issue prices of the liabilities.

One commentator has asked that this condition be modified. The commentator suggested that either the three- year liquidation period should be extended to four years or an entity should have to liquidate only a certain percentage of its assets within the three-year period. The commentator alternatively suggested that an entity should be treated as meeting the condition if it satisfies fifty percent of the issue price of each of its liabilities using liquidation proceeds.

The final regulations retain the three-year liquidation rule. The IRS and Treasury believe that performing mortgages that conform to current underwriting standards may easily be disposed of within that time. Further, the market has developed to the point where three years is also ample time to dispose of non-performing mortgages. Mortgages that require more than three years for disposal are more likely to be seriously impaired, and a taxpayer who holds a sufficient quantity can avoid taxable mortgage pool classification by other means. The final regulations, therefore, do not change the basic rules in the proposed regulations.

Section 301.7701–1(g)—Anti-Avoidance Rules

An anti-avoidance rule in the proposed regulations authorizes the Commissioner to disregard or make other adjustments to any transaction if the transaction is entered into with a view to achieving the same economic effect as that of an arrangement subject to section 7701(i) while avoiding the application of that section. This authority is flexible, and among other things, includes the ability to override any safe harbor otherwise available under the regulations. The final regulations retain the anti-avoidance rule and provide two additional examples illustrating its exercise.

Section 301.7701(i)–4—Certain Governmental Entities Not Treated as Taxable Mortgage Pools

The proposed regulations provide that an entity is not classified as a taxable mortgage pool if: (1) The entity issuing the debt obligations is a State, the District of Columbia, or a political subdivision within the meaning of § 1.103–1(b), or is empowered to issue obligations on behalf of one of the foregoing; (2) the entity issues the debt obligations in the performance of a governmental purpose; and (3) the entity holds the remaining interest in any asset that supports the outstanding debt obligations until those obligations are satisfied.

Two commentators have asked that the third requirement be dropped because it prevents a governmental entity from reselling a package of mortgages. The IRS and Treasury believe, however, that dropping the requirement is inappropriate. Typically, when a mortgage pool is used to create multiple class debt, tax gains in excess of economic gains are generated during the early part of the pool's life and tax losses in excess of economic losses are generated during the latter part of the pool's life. Without the third requirement, a governmental entity can hold an interest in the pool during the early period and then convey that interest to a taxable entity during the latter period. Moreover, requiring a governmental entity to maintain an interest in pool assets is consistent with the second requirement that debt obligations supported by the pool are issued in performance of a governmental purpose.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Marshall D. Feiring and Arnold P. Golub, Office of Assistant Chief Counsel (Financial Institutions and Products), and Carol E. Schultze, formerly of that office. However, other personnel from the IRS and Treasury Department participated in their development.

The Office of Assistant Chief Counsel (Financial Institutions and Products) notes with sadness the passing of Susan E. Overlander, who contributed significantly to this project.

List of Subjects in 26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding the following citations in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 301.7701(i)–1(g)(1) also issued under 26 U.S.C. 7701(i)(2)(D).

Section 301.7701(i)–4(b) also issued under 26 U.S.C. 7701(i)(3). * * *

Par. 2. Sections 301.7701(i)–0 through 301.7701(i)–4 are added to read as follows:

§ 301.7701(i)–0 Outline of taxable mortgage pool provisions.

This section lists the major paragraphs contained in §§ 301.7701(i)–1 through 301.7701(i)–4.

§ 301.7701(i)–1 Definition of a taxable mortgage pool.

(a) *Purpose.* This section provides rules for applying section 7701(i), which defines taxable mortgage pools. The purpose of section 7701(i) is to prevent income generated by a pool of real estate mortgages from escaping Federal income taxation when the pool is used to issue multiple class mortgage-backed securities. The regulations in this section and in §§ 301.7701(i)–2 through 301.7701(i)–4 are to be applied in accordance with this purpose. The taxable mortgage pool provisions apply to entities or portions of entities that qualify for REMIC status but do not elect to be taxed as REMICs as well as to certain entities or portions of entities that do not qualify for REMIC status.

(b) *In general.* (1) A taxable mortgage pool is any entity or portion of an entity (as defined in § 301.7701(i)–2) that satisfies the requirements of section 7701(i)(2)(A) and this section as of any testing day (as defined in § 301.7701(i)–3(c)(2)). An entity or portion of an entity satisfies the requirements of section 7701(i)(2)(A) and this section if substantially all of its assets are debt obligations, more than 50 percent of those debt obligations are real estate mortgages, the entity is the obligor under debt obligations with two or more maturities, and payments on the debt obligations under which the entity is obligor bear a relationship to payments on the debt obligations that the entity holds as assets.

(2) Paragraph (c) of this section provides the tests for determining whether substantially all of an entity's assets are debt obligations and for determining whether more than 50 percent of its debt obligations are real estate mortgages. Paragraph (d) of this section defines real estate mortgages for purposes of the 50 percent test. Paragraph (e) of this section defines two or more maturities and paragraph (f) of this section provides rules for determining whether debt obligations bear a relationship to the assets held by an entity. Paragraph (g) of this section provides anti-avoidance rules. Section 301.7701(i)–2 provides rules for applying section 7701(i) to portions of entities and § 301.7701(i)–3 provides effective dates. Section 301.7701(i)–4 provides special rules for certain entities. For purposes of the regulations under section 7701(i), the term entity includes a portion of an entity (within the meaning of section 7701(i)(2)(B)), unless the context clearly indicates otherwise.

(c) *Asset composition tests*—(1) *Determination of amount of assets.* An entity must use the Federal income tax basis of an asset for purposes of determining whether substantially all of its assets consist of debt obligations (or interests therein) and whether more than 50 percent of those debt obligations (or interests) consist of real estate mortgages (or interests therein). For purposes of this paragraph, an entity determines the basis of an asset with the assumption that the entity is not a taxable mortgage pool.

(2) *Substantially all*—(i) *In general.* Whether substantially all of the assets of an entity consist of debt obligations (or interests therein) is based on all the facts and circumstances.

(ii) *Safe harbor.* Notwithstanding paragraph (c)(2)(i) of this section, if less than 80 percent of the assets of an entity consist of debt obligations (or interests therein), then less than substantially all of the assets of the entity consist of debt obligations (or interests therein).

(3) *Equity interests in pass-through arrangements.* The equity interest of an entity in a partnership, S corporation, trust, REIT, or other pass-through arrangement is deemed to have the same composition as the entity's share of the assets of the pass-through arrangement. For example, if an entity's stock interest in a REIT has an adjusted basis of $20,000, and the assets of the REIT consist of equal portions of real estate mortgages and other real estate assets, then the entity is treated as holding $10,000 of real estate mortgages and $10,000 of other real estate assets.

(4) *Treatment of certain credit enhancement contracts*—(i) *In general.* A credit enhancement contract (as defined in paragraph (c)(4)(ii) of this section) is not treated as a separate asset of an entity for purposes of the asset composition tests set forth in section

7701(i)(2)(A)(i), but instead is treated as part of the asset to which it relates. Furthermore, any collateral supporting a credit enhancement contract is not treated as an asset of an entity solely because it supports the guarantee represented by that contract.

(ii) *Credit enhancement contract defined.* For purposes of this section, a credit enhancement contract is any arrangement whereby a person agrees to guarantee full or partial payment of the principal or interest payable on a debt obligation (or interest therein) or on a pool of such obligations (or interests), or full or partial payment on one or more classes of debt obligations under which an entity is the obligor, in the event of defaults or delinquencies on debt obligations, unanticipated losses or expenses incurred by the entity, or lower than expected returns on investments. Types of credit enhancement contracts may include, but are not limited to, pool insurance contracts, certificate guarantee insurance contracts, letters of credit, guarantees, or agreements whereby an entity, a mortgage servicer, or other third party agrees to make advances (regardless of whether, under the terms of the agreement, the payor is obligated, or merely permitted, to make those advances). An agreement by a debt servicer to advance to an entity out of its own funds an amount to make up for delinquent payments on debt obligations is a credit enhancement contract. An agreement by a debt servicer to pay taxes and hazard insurance premiums on property securing a debt obligation, or other expenses incurred to protect an entity's security interests in the collateral in the event that the debtor fails to pay such taxes, insurance premium, or other expenses, is a credit enhancement contract.

(5) *Certain assets not treated as debt obligations*—(i) *In general.* For purposes of section 7701(i)(2)(A), real estate mortgages that are seriously impaired are not treated as debt obligations. Whether a mortgage is seriously impaired is based on all the facts and circumstances including, but not limited to: the number of days delinquent, the loan-to-value ratio, the debt service coverage (based upon the operating income from the property), and the debtor's financial position and stake in the property. However, except as provided in paragraph (c)(5)(ii) of this section, no single factor in and of itself is determinative of whether a loan is seriously impaired.

(ii) *Safe harbor*—(A) *In general.* Unless an entity is receiving or anticipates receiving payments with respect to a mortgage, a single family residential real estate mortgage is seriously impaired if payments on the mortgage are more than 89 days delinquent, and a multi-family residential or commercial real estate mortgage is seriously impaired if payments on the mortgage are more than 59 days delinquent. Whether an entity anticipates receiving payments with respect to a mortgage is based on all the facts and circumstances.

(B) *Payments with respect to a mortgage defined.* For purposes of paragraph (c)(5)(ii)(A) of this section, payments with respect to a mortgage mean any payments on the mortgage as defined in paragraph (f)(2)(i) of this section if those payments are substantial and relatively certain as to amount and any payments on the mortgage as defined in paragraph (f)(2) (ii) or (iii) of this section.

(C) *Entity treated as not anticipating payments.* With respect to any testing day (as defined in § 301.7701(i)–3(c)(2)), an entity is treated as not having anticipated receiving payments on the mortgage as defined in paragraph (f)(2)(i) of this section if 180 days after the testing day, and despite making reasonable efforts to resolve the mortgage, the entity is not receiving such payments and has not entered into any agreement to receive such payments.

(d) *Real estate mortgages or interests therein defined*—(1) *In general.* For purposes of section 7701(i)(2)(A)(i), the term real estate mortgages (or interests therein) includes all—

(i) Obligations (including participations or certificates of beneficial ownership therein) that are principally secured by an interest in real property (as defined in paragraph (d)(3) of this section);

(ii) Regular and residual interests in a REMIC; and

(iii) Stripped bonds and stripped coupons (as defined in section 1286(e) (2) and (3)) if the bonds (as defined in section 1286(e)(1)) from which such stripped bonds or stripped coupons arose would have qualified as real estate mortgages or interests therein.

(2) *Interests in real property and real property defined*—(i) *In general.* The definition of interests in real property set forth in § 1.856–3(c) of this chapter and the definition of real property set forth in § 1.856–3(d) of this chapter apply to define those terms for purposes of paragraph (d) of this section.

(ii) *Manufactured housing.* For purposes of this section, the definition of real property includes manufactured housing, provided the properties qualify as single family residences under section 25(e)(10) and without regard to the treatment of the properties under state law.

(3) *Principally secured by an interest in real property*—(i) *Tests for determining whether an obligation is principally secured.* For purposes of paragraph (d)(1) of this section, an obligation is principally secured by an interest in real property only if it satisfies either the test set out in paragraph (d)(3)(i)(A) of this section or the test set out in paragraph (d)(3)(i)(B) of this section.

(A) *The 80 percent test.* An obligation is principally secured by an interest in real property if the fair market value of the interest in real property (as defined in paragraph (d)(2) of this section) securing the obligation was at least equal to 80 percent of the adjusted issue price of the obligation at the time the obligation was originated (that is, the issue date). For purposes of this test, the fair market value of the real property interest is first reduced by the amount of any lien on the real property interest that is senior to the obligation being tested, and is reduced further by a proportionate amount of any lien that is in parity with the obligation being tested.

(B) *Alternative test.* An obligation is principally secured by an interest in real property if substantially all of the proceeds of the obligation were used to acquire, improve, or protect an interest in real property that, at the origination date, is the only security for the obligation. For purposes of this test, loan guarantees made by Federal, state, local governments or agencies, or other third party credit enhancement, are not viewed as additional security for a loan. An obligation is not considered to be secured by property other than real property solely because the obligor is personally liable on the obligation.

(ii) *Obligations secured by real estate mortgages (or interests therein), or by combinations of real estate mortgages (or interests therein) and other assets*—(A) *In general.* An obligation secured only by real estate mortgages (or interests therein), as defined in paragraph (d)(1) of this section, is treated as an obligation secured by an interest in real property to the extent of the value of the real estate mortgages (or interests therein). An obligation secured by both real estate mortgages (or interests therein) and other assets is treated as an obligation secured by an interest in real property to the extent of both the value of the real estate mortgages (or interests therein) and the value of so much of the other assets that constitute real property. Thus, under this paragraph, a collateralized mortgage obligation may be an obligation principally secured by an interest in real property. This section is applicable only to obligations issued after December 31, 1991.

(B) *Example.* The following example illustrates the principles of this paragraph (d)(3)(ii):

Example. At the time it is originated, an obligation has an adjusted issue price of $300,000 and is secured by a $70,000 loan principally secured by an interest in a single family home, a fifty percent co-ownership interest in a $400,000 parcel of land, and $80,000 of stock. Under paragraph (d)(3)(ii)(A) of this section, the obligation is treated as secured by interests in real property and under paragraph (d)(3)(i)(A) of this section, the obligation is treated as principally secured by interests in real property.

(e) *Two or more maturities*—(1) *In general.* For purposes of section 7701(i)(2)(A)(ii), debt obligations have two or more maturities if they have different stated maturities or if the holders of the obligations possess different rights concerning the acceleration of or delay in the maturities of the obligations.

(2) *Obligations that are allocated credit risk unequally.* Debt obligations that are allocated credit risk unequally do not have, by that reason alone, two or more maturities. Credit risk is the risk that payments of principal or interest will be reduced or delayed because of a default on an asset that supports the debt obligations.

(3) *Examples.* The following examples illustrate the principles of this paragraph (e):

Example 1. (i) Corporation M transfers a pool of real estate mortgages to a trustee in exchange for Class A bonds and a certificate representing the residual beneficial ownership of the pool. All Class A bonds have a stated maturity of March 1, 2002, but if cash flows from the real estate mortgages and investments are sufficient, the trustee may select one or more bonds at random and redeem them earlier.

(ii) The Class A bonds do not have different maturities. Each outstanding Class A bond has an equal chance of being redeemed because the selection process is random. The holders of the Class A bonds, therefore, have identical rights concerning the maturities of their obligations.

Example 2. (i) Corporation N transfers a pool of real estate mortgages to a trustee in exchange for Class C bonds, Class D bonds, and a certificate representing the residual beneficial ownership of the pool. The Class D bonds are subordinate to the Class C bonds so that cash flow shortfalls due to defaults or delinquencies on the real estate mortgages are borne first by the Class D bond holders. The terms of the bonds are otherwise identical in all relevant aspects except that the Class D bonds carry a higher coupon rate because of the subordination feature.

(ii) The Class C bonds and the Class D bonds share credit risk unequally because of the subordination feature. However, neither this difference, nor the difference in interest rates, causes the bonds to have different maturities. The result is the same if, in addition to the other terms described in paragraph (i) of this *Example 2,* the Class C bonds are accelerated as a result of the issuer becoming unable to make payments on the Class C bonds as they become due.

(f) *Relationship test*—(1) *In general.* For purposes of section 7701(i)(2)(A)(iii), payments on debt obligations under which an entity is the obligor (liability obligations) bear a relationship to payments (as defined in paragraph (f)(2) of this section) on debt obligations an entity holds as assets (asset obligations) if under the terms of the liability obligations (or underlying arrangement) the timing and amount of payments on the liability obligations are in large part determined by the timing and amount of payments or projected payments on the asset obligations. For purposes of the relationship test, any payment arrangement, including a swap or other hedge, that achieves a substantially similar result is treated as satisfying the test. For example, any arrangement where the timing and amount of payments on liability obligations are determined by reference to a group of assets (or an index or other type of model) that has an expected payment experience similar to that of the asset obligations is treated as satisfying the relationship test.

(2) *Payments on asset obligations defined.* For purposes of section 7701(i)(2)(A)(iii) and this section, payments on asset obligations include—

(i) A payment of principal or interest on an asset obligation, including a prepayment of principal, a payment under a credit enhancement contract (as defined in paragraph (c)(4)(ii) of this section) and a payment from a settlement at a discount (other than a substantial discount);

(ii) A payment from a settlement at a substantial discount, but only if the settlement is arranged, whether in writing or otherwise, prior to the issuance of the liability obligations; and

(iii) A payment from the foreclosure on or sale of an asset obligation, but only if the foreclosure or sale is arranged, whether in writing or otherwise, prior to the issuance of the liability obligations.

(3) *Safe harbor for entities formed to liquidate assets.* Payments on liability obligations of an entity do not bear a relationship to payments on asset obligations of the entity if—

(i) The entity's organizational documents manifest clearly that the entity is formed for the primary purpose of liquidating its assets and distributing proceeds of liquidation;

(ii) The entity's activities are all reasonably necessary to and consistent with the accomplishment of liquidating assets;

(iii) The entity plans to satisfy at least 50 percent of the total issue price of each of its liability obligations having a different maturity with proceeds from liquidation and not with scheduled payments on its asset obligations; and

(iv) The terms of the entity's liability obligations (or underlying arrangement) provide that within three years of the time it first acquires assets to be liquidated the entity either—

(A) Liquidates; or

(B) Begins to pass through without delay all payments it receives on its asset obligations (less reasonable allowances for expenses) as principal payments on its liability obligations in proportion to the adjusted issue prices of the liability obligations.

(g) *Anti-avoidance rules*—(1) *In general.* For purposes of determining whether an entity meets the definition of a taxable mortgage pool, the Commissioner can disregard or make other adjustments to a transaction (or series of transactions) if the transaction (or series) is entered into with a view to achieving the same economic effect as that of an arrangement subject to section 7701(i) while avoiding the application of that section. The Commissioner's authority includes treating equity interests issued by a non-REMIC as debt if the entity issues equity interests that correspond to maturity classes of debt.

(2) *Certain investment trusts.* Notwithstanding paragraph (g)(1) of this section, an ownership interest in an entity that is classified as a trust under § 301.7701–4(c) will not be treated as a debt obligation of the trust.

(3) *Examples.* The following examples illustrate the principles of this paragraph (g):

Example 1. (i) Partnership P, in addition to its other investments, owns $10,000,000 of mortgage pass-through certificates guaranteed by FNMA (FNMA Certificates). On May 15, 1997, Partnership P transfers the FNMA Certificates to Trust 1 in exchange for 100 Class A bonds and Certificate 1. The Class A bonds, under which Trust 1 is the obligor, have a stated principal amount of $5,000,000 and bear a relationship to the FNMA Certificates (within the meaning of § 301.7701(i)–1(f)). Certificate 1 represents the residual beneficial ownership of the FNMA Certificates.

(ii) On July 5, 1997, with a view to avoiding the application of section 7701(i), Partnership P transfers Certificate 1 to Trust 2 in exchange for 100 Class B bonds and Certificate 2. The Class B bonds, under which

Trust 2 is the obligor, have a stated principal amount of $5,000,000, bear a relationship to the FNMA Certificates (within the meaning of § 301.7701(i)-1(f)), and have a different maturity than the Class A bonds (within the meaning of § 301.7701(i)-1(e)). Certificate 2 represents the residual beneficial ownership of Certificate 1.

(iii) For purposes of determining whether Trust 1 is classified as a taxable mortgage pool, the Commissioner can disregard the separate existence of Trust 2 and treat Trust 1 and Trust 2 as a single trust.

Example 2. (i) Corporation Q files a consolidated return with its two wholly-owned subsidiaries, Corporation R and Corporation S. Corporation R is in the business of building and selling single family homes. Corporation S is in the business of financing sales of those homes.

(ii) On August 10, 1998, Corporation S transfers a pool of its real estate mortgages to Trust 3, taking back Certificate 3 which represents beneficial ownership of the pool. On September 25, 1998, with a view to avoiding the application of section 7701(i), Corporation R issues bonds that have different maturities (within the meaning of § 301.7701(i)–1(e)) and that bear a relationship (within the meaning of § 301.7701(i)-1(f)) to the real estate mortgages in Trust 3. The holders of the bonds have an interest in a credit enhancement contract that is written by Corporation S and collateralized with Certificate 3.

(iii) For purposes of determining whether Trust 3 is classified as a taxable mortgage pool, the Commissioner can treat Trust 3 as the obligor of the bonds issued by Corporation R.

Example 3. (i) Corporation X, in addition to its other assets, owns $110,000,000 in Treasury securities. From time to time, Corporation X acquires pools of real estate mortgages, which it immediately uses to issue multiple-class debt obligations.

(ii) On October 1, 1996, Corporation X transfers $20,000,000 in Treasury securities to Trust 4 in exchange for Class C bonds, Class D bonds, Class E bonds, and Certificate 4. Trust 4 is the obligor of the bonds. The different classes of bonds have the same stated maturity date, but if cash flows from the Trust 4 assets exceed the amounts needed to make interest payments, the trustee uses the excess to retire the classes of bonds in alphabetical order. Certificate 4 represents the residual beneficial ownership of the Treasury securities.

(iii) With a view to avoiding the application of section 7701(i), Corporation X reserves the right to replace any Trust 4 asset with real estate mortgages or guaranteed mortgage pass-through certificates. In the event the right is exercised, cash flows on the real estate mortgages and guaranteed pass-through certificates will be used in the same manner as cash flows on the Treasury securities. Corporation X exercises this right of replacement on February 1, 1997.

(iv) For purposes of determining whether Trust 4 is classified as a taxable mortgage pool, the Commissioner can treat February 1, 1997, as a testing day (within the meaning of § 301.7701(i)-3(c)(2)). The result is the same if Corporation X has an obligation, rather than a right, to replace the Trust 4 assets with real estate mortgages and guaranteed pass-through certificates.

Example 4. (i) Corporation Y, in addition to its other assets, owns $1,900,000 in obligations secured by personal property. On November 1, 1995, Corporation Y begins negotiating a $2,000,000 loan to individual A. As security for the loan, A offers a first deed of trust on land worth $1,700,000.

(ii) With a view to avoiding the application of section 7701(i), Corporation Y induces A to place the land in a partnership in which A will have a 95 percent interest and agrees to accept the partnership interest as security for the $2,000,000 loan. Thereafter, the loan to A, together with the $1,900,000 in obligations secured by personal property, are transferred to Trust 5 and used to issue bonds that have different maturities (within the meaning of § 301.7701(i)-1(e)) and that bear a relationship (within the meaning of § 301.7701(i)-1(f)) to the $1,900,000 in obligations secured by personal property and the loan to A.

(iii) For purposes of determining whether Trust 5 is a taxable mortgage pool, the Commissioner can treat the loan to A as an obligation secured by an interest in real property rather than as an obligation secured by an interest in a partnership.

Example 5. (i) Corporation Z, in addition to its other assets, owns $3,000,000 in notes secured by interests in retail shopping centers. Partnership L, in addition to its other assets, owns $20,000,000 in notes that are principally secured by interests in single family homes and $3,500,000 in notes that are principally secured by interests in personal property.

(ii) On December 1, 1995, Partnership L asks Corporation Z for two separate loans, one in the amount of $9,375,000 and another in the amount of $625,000. Partnership L offers to collateralize the $9,375,000 loan with $10,312,500 of notes secured by interests in single family homes and the $625,000 loan with $750,000 of notes secured by interests in personal property. Corporation Z has made similar loans to Partnership L in the past.

(iii) With a view to avoiding the application of section 7701(i), Corporation Z induces Partnership L to accept a single $10,000,000 loan and to post as collateral $7,500,000 of the notes secured by interests in single family homes and all $3,500,000 of the notes secured by interests in personal property. Ordinarily, Corporation Z would not make a loan on these terms. Thereafter, the loan to Partnership L, together with the $3,000,000 in notes secured by interests in retail shopping centers, are transferred to Trust 6 and used to issue bonds that have different maturities (within the meaning of § 301.7701(i)–1(e)) and that bear a relationship (within the meaning of § 301.7701(i)–1(f)) to the loans secured by interests in retail shopping centers and the loan to Partnership L.

(iv) For purposes of determining whether Trust 6 is a taxable mortgage pool, the Commissioner can treat the $10,000,000 loan to Partnership L as consisting of a $9,375,000 obligation secured by interests in real property and a $625,000 obligation secured by interests in personal property. Under § 301.7701(i)–1(d)(3)(ii)(A), the notes secured by single family homes are treated as $7,500,000 of interests in real property. Under § 301.7701(i)–1(d)(3)(i)(A), $7,500,000 of interests in real property are sufficient to treat the $9,375,000 obligation as principally secured by an interest in real property ($7,500,000 equals 80 percent of $9,375,000).

§ 301.7701(i)–2 Special rules for portions of entities.

(a) *Portion defined.* Except as provided in paragraph (b) of this section and § 301.7701(i)–1, a portion of an entity includes all assets that support one or more of the same issues of debt obligations. For this purpose, an asset supports a debt obligation if, under the terms of the debt obligation (or underlying arrangement), the timing and amount of payments on the debt obligation are in large part determined, either directly or indirectly, by the timing and amount of payments or projected payments on the asset or a group of assets that includes the asset. Indirect payment arrangements include, for example, a swap or other hedge, or arrangements where the timing and amount of payments on the debt obligations are determined by reference to a group of assets (or an index or other type of model) that has an expected payment experience similar to that of the assets. For purposes of this paragraph, the term payments includes all proceeds and receipts from an asset.

(b) *Certain assets and rights to assets disregarded*—(1) *Credit enhancement assets.* An asset that qualifies as a credit enhancement contract (as defined in § 301.7701(i)–1(c)(4)(ii)) is not included in a portion as a separate asset, but is treated as part of the assets in the portion to which it relates under § 301.7701(i)–1(c)(4)(i). An asset that does not qualify as a credit enhancement contract (as defined in § 301.7701(i)–1(c)(4)(ii)), but that nevertheless serves the same function as a credit enhancement contract, is not included in a portion as a separate asset or otherwise.

(2) *Assets unlikely to service obligations.* A portion does not include assets that are unlikely to produce any significant cash flows for the holders of the debt obligations. This paragraph applies even if the holders of the debt obligations are legally entitled to cash flows from the assets. Thus, for example, even if the sale of a building would cause a series of debt obligations to be redeemed, the building is not included in a portion if it is not likely to be sold.

(3) *Recourse.* An asset is not included in a portion solely because the holders

of the debt obligations have recourse to the holder of that asset.

(c) *Portion as obligor*—(1) *In general.* For purposes of section 7701(i)(2)(A)(ii), a portion of an entity is treated as the obligor of all debt obligations supported by the assets in that portion.

(2) *Example.* The following example illustrates the principles of this section:

Example. (i) Corporation Z owns $1,000,000,000 in assets including an office complex and $90,000,000 of real estate mortgages.

(ii) On November 30, 1998, Corporation Z issues eight classes of bonds, Class A through Class H. Each class is secured by a separate letter of credit and by a lien on the office complex. One group of the real estate mortgages supports Class A through Class D, another group supports Class E through Class G, and a third group supports Class H. It is anticipated that the cash flows from each group of mortgages will service its related bonds.

(iii) Each of the following constitutes a separate portion of Corporation Z: the group of mortgages supporting Class A through Class D; the group of mortgages supporting Class E through Class G; and the group of mortgages supporting Class H. No other asset is included in any of the three portions notwithstanding the lien of the bonds on the office complex and the fact that Corporation Z is the issuer of the bonds. The letters of credit are treated as incidents of the mortgages to which they relate.

(iv) For purposes of section 7701(i)(2)(A)(ii), each portion described above is treated as the obligor of the bonds of that portion, notwithstanding the fact that Corporation Z is the legal obligor with respect to the bonds.

§ 301.7701(i)–3 Effective dates and duration of taxable mortgage pool classification.

(a) *Effective dates.* Except as otherwise provided, the regulations under section 7701(i) are effective and applicable September 6, 1995.

(b) *Entities in existence on December 31, 1991*—(1) *In general.* For transitional rules concerning the application of section 7701(i) to entities in existence on December 31, 1991, see section 675(c) of the Tax Reform Act of 1986.

(2) *Special rule for certain transfers.* A transfer made to an entity on or after September 6, 1995, is a substantial transfer for purposes of section 675(c)(2) of the Tax Reform Act of 1986 only if—

(i) The transfer is significant in amount; and

(ii) The transfer is connected to the entity's issuance of related debt obligations (as defined in paragraph (b)(3) of this section) that have different maturities (within the meaning of § 301.7701–1(e)).

(3) *Related debt obligation.* A related debt obligation is a debt obligation whose payments bear a relationship (within the meaning of § 301.7701–1(f)) to payments on debt obligations that the entity holds as assets.

(4) *Example.* The following example illustrates the principles of this paragraph (b):

Example. On December 31, 1991, Partnership Q holds a pool of real estate mortgages that it acquired through retail sales of single family homes. Partnership Q raises $10,000,000 on October 25, 1996, by using this pool to issue related debt obligations with multiple maturities. The transfer of the $10,000,000 to Partnership Q is a substantial transfer (within the meaning of § 301.7701(i)–3(b)(2)).

(c) *Duration of taxable mortgage pool classification*—(1) *Commencement and duration.* An entity is classified as a taxable mortgage pool on the first testing day that it meets the definition of a taxable mortgage pool. Once an entity is classified as a taxable mortgage pool, that classification continues through the day the entity retires its last related debt obligation.

(2) *Testing day defined.* A testing day is any day on or after September 6, 1995, on which an entity issues a related debt obligation (as defined in paragraph (b)(3) of this section) that is significant in amount.

§ 301.7701(i)–4 Special rules for certain entities.

(a) *States and municipalities*—(1) *In general.* Regardless of whether an entity satisfies any of the requirements of section 7701(i)(2)(A), an entity is not classified as a taxable mortgage pool if—

(i) The entity is a State, territory, a possession of the United States, the District of Columbia, or any political subdivision thereof (within the meaning of § 1.103–1(b) of this chapter), or is empowered to issue obligations on behalf of one of the foregoing;

(ii) The entity issues the debt obligations in the performance of a governmental purpose; and

(iii) The entity holds the remaining interests in all assets that support those debt obligations until the debt obligations issued by the entity are retired.

(2) *Governmental purpose.* The term governmental purpose means an essential governmental function within the meaning of section 115. A governmental purpose does not include the mere packaging of debt obligations for re-sale on the secondary market even if any profits from the sale are used in the performance of an essential governmental function.

(3) *Determinations by the Commissioner.* If an entity is not described in paragraph (a)(1) of this section, but has a similar purpose, then the Commissioner may determine that the entity is not classified as a taxable mortgage pool.

(b) *REITs.* [Reserved]

(c) *Subchapter S corporations*—(1) *In general.* An entity that is classified as a taxable mortgage pool may not elect to be an S corporation under section 1362(a) or maintain S corporation status.

(2) *Portion of an S corporation treated as a separate corporation.* An S corporation is not treated as a member of an affiliated group under section 1361(b)(2)(A) solely because a portion of the S corporation is treated as a separate corporation under section 7701(i).

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved: July 17, 1995.

Leslie Samuels,
Assistant Secretary of the Treasury.

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DEPARTMENT OF JUSTICE

Parole Commission

28 CFR Part 2

Paroling, Recommitting, and Supervising Federal Prisoners: Revision of the Salient Factor Score

AGENCY: Parole Commission, Justice.

ACTION: Final rule.

SUMMARY: The U.S. Parole Commission is revising the salient factor score at 28 CFR 2.20. The salient factor score is an actuarial device which the Commission uses to measure the risk that a prisoner will violate parole. The revised Salient Factor Score will improve the accuracy of the Commission's recidivism predictions in the case of older prisoners. Under the revised score (to be known as SFS–95), the Commission will add one point to the prisoner's total score if the prisoner was 41 years of age or more at the commencement of the current offense (or parole violation), provided the prisoner does not already have the highest possible total score (10). The revision is made appropriate by the fact that the Parole Commission has jurisdiction over an aging population of prisoners and parolees whose crimes were committed prior to November 1, 1987.

EFFECTIVE DATE: October 2, 1995.

FOR FURTHER INFORMATION CONTACT: Pamela A. Posch, Office of General Counsel, U.S. Parole Commission, 5550 Friendship Blvd., Chevy Chase,